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Regional trade agreements in Africa: Success or failure?

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Regional trade agreements (RTAs) have been proliferating in the past three decades, reflecting among other things the increasing involvement of developing economies in international trade. In Africa, particularly in sub-Saharan Africa, the first RTAs were established as mechanisms that would facilitate the continent's unity in post-colonial times. Even today, the majority of African RTAs go beyond the economic objectives of increased industrialisation and trade, aiming at promoting democracy, preventing regional conflicts, harmonising institutional development, etc.1 The economic performance of most African RTAs has not met the expectations of member countries, partly due to below-potential market integration that reflects high trade barriers. However, beyond the removal of trade barriers, when combined with political benefits, the potential deep-integration outcomes of RTAs in Africa can substantially contribute to the inclusion of these economies in global value chains.

From a physical and economic geography perspective, regional integration is generally expected to result in higher gains the smaller an economy is. When small markets are combined, regional integration leads to economies of scale. Guillaumont (2013, p. 280) estimates that if the Economic and Monetary Community of Central Africa (CEMAC) customs union and the West African Economic and Monetary Union (UEMOA) customs union had been integrated into a single economy over the period 1976-2011, the average annual per capita income growth in CEMAC and UEMOA would have been 1.7 percentage points and 1.9 percentage points higher, respectively. Moreover, Collier and Venables (2009) show that regional integration has the highest payoffs for landlocked countries which are highly dependent on resource-based exports. Integration in this case would result in a bigger economy and thus, higher output, which would slow down the pace of diminishing returns to the extraction of natural resources.

How have African RTAs performed?

Studies show that trade, investment and growth usually increase following reductions in protection levels (e.g. Warcziarg and Welch 2008). For African RTAs studies on the link between integration and economic growth have been inconclusive so far, mainly due to identification problems related to high growth volatility and internal and external economic shocks. However, we can infer some first round effects of RTAs based on the evolution of intra-regional trade before and after an agreement is signed. Data reveals that for the main RTAs in Africa, intra-regional imports represent less than 10% of total regional imports, and this share shows an increasing trend post establishment of an RTA only for the Pan-Arab Free Trade Area (PAFTA) and the South African Development Community (SADC) (de Melo and Tsikata 2013). Another way of inferring the performance of RTAs is through estimates of a 'gravity model of trade', which show the potential trade flows between two countries. Gravity models are consistent with two well established stylised facts:

1. Exports increase proportionally with the size of the destination market and imports increase proportionately with the size of the origin country.
2. There is a strong negative relationship between distance – a proxy for trade costs – and bilateral trade.

Estimates show that African RECs on average trade 40% less than potential trade (i.e. trade in a frictionless world) (de Melo and Tsikata 2013). Furthermore, the ratio of actual to potential trade, which can be thought of as a proxy for trade costs, seems to have decreased upon implementation of an RTA only for the East African Community (EAC) going from 0.63 two years before the RTA was signed to 0.53 seven years after the RTA was signed.

The sub-optimal effects of African RTAs on trade and incomes can be explained by many factors, including:

- large cost differences between the most efficient member in the region and lost cost external producer, because of which an RTA results in welfare-decreasing trade diversion;2
- low trade complementarity between members of an RTA, which results in stagnant inter-industry trade in the region;
- high non-tariff barriers in the bloc (high trade costs), related to both 'hard' infrastructure, like transport costs, and 'soft' infrastructure, like harmonised rules and regulations; and
- a high degree of diversity among members of an RTA (resource-abundant vs. resource-poor, landlocked vs. coastal, artificial borders, etc.), which results in very diverse interests for different members.

To illustrate these factors at play, let us take some examples of particular countries' outcomes after membership in RTAs: i) Rwanda, a landlocked, resource-poor economy, and the EAC; and ii) Liberia, a coastal, resource-rich economy, and ECOWAS. Rwanda joined the EAC in 2007. While moving to the common external tariff (CET) increased Rwanda's exports due to lower tariffs on inputs, the cost of living for the poor population was negatively affected, mainly due to higher price of staple foods like sugar, whose imports from Kenya replaced more efficient external producers (de Melo and Collinson 2011). Similarly for Liberia, by joining the CET of ECOWAS, while tariff revenues are expected to increase, a higher average protection (from 5.3% to 13.6%) is expected to adversely affect the consumption basket of the poorer strata of the population (de Melo and Mancellari 2013). Furthermore, estimates reveal that around 90% of new intra-regional imports following the adoption of the CET would be diverted away from existing external trading partners, resulting in negative net welfare effects.

Given the balance of costs and benefits, should African economies continue to invest resources in RTAs?

The answer is **yes**, although global trade strategies should be pursued in parallel with regional ones. Despite the sub-optimal economic outcomes of African RTAs, the experience of RTAs around the world supports the view that economic and political incentives are complements. RTAs reduce the probability of conflict in two ways: trade increases the opportunity cost of war; and sufficiently deep RTAs reduce information asymmetries between countries, thus incentives for countries not to report their true options in an attempt to extract concessions are reduced. However, many African RTAs are founded upon and operate under 20th century regionalism, in which regional integration is a bargain about an exchange of market access at the expense of outsiders. With the reduction in trade costs and the subsequent fragmentation of production, 21st century regionalism is about a new bargain: an exchange of domestic market reforms for FDI, which brings home the services activities necessary to participate in the global value chain.

Further reading

Collier, P and A J Venables (2009), "Trade and economic performance: does Africa's fragmentation matter?", Revue d'économie du développement 23(4), pp. 5-39.

Guillaumont, P (2013), "Impact de l'intégration sur la croissance", Chapter 7 in Geourjon et al. (eds), pp. 249-84.

de Melo, J and A Mancellari (2013), "Regional and Global Trade Strategies for Liberia", IGC Working Paper.

Melo, J. de, and Laura Collinson (2011), "Getting the Best out of Regional Integration: Some Thoughts for Rwanda", IGC Working Paper.

Melo, J. de, and Yvonne Tsikata (2013) "Regional Integration in Africa: Challenges and Prospects", mimeo, a commissioned paper for the forthcoming OUP Handbook of Africa and Economics.

Warcziarg, R. and K. Welch (2008), "Trade Liberalization and Growth: New Evidence", World Bank Economic Review 22(2): 187-23.

Notes

1 For a complete list of African RTAs and their objectives, see de Melo and Tsikata (2013).

2 Trade diversion occurs when imports from members of an RTA displace imports from more efficient external producers, because preferential treatment is given to the RTA member (e.g.

reduced tariffs).